

Irish Fiscal Advisory Council

Strengthening Fiscal Institutions: The Role(s) of a Fiscal Council

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Irish Fiscal Advisory Council

Overview

- Role of fiscal councils
- Design of Irish Fiscal Advisory Council
- First Fiscal Assessment Report
- Next challenges

Principles of good fiscal policy

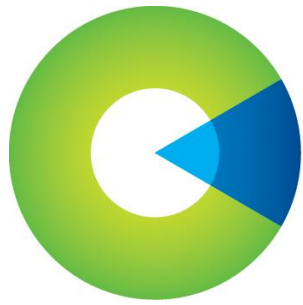
- Macroeconomic perspective (deficits and debt)
- Active debate in the literature
 - “Irrelevance of deficits” result (Barro/Ricardian equivalence) . . . but relaxing the assumptions shows how deficits matter
- But some broadly agreed principles of sound fiscal management
 - Stable fiscal system
 - Intergenerational fairness
 - “Smooth” tax rates over time
 - Need to retain creditworthiness
 - Value of counter-cyclical fiscal actions (requires “fiscal space”)

Political biases in fiscal policy

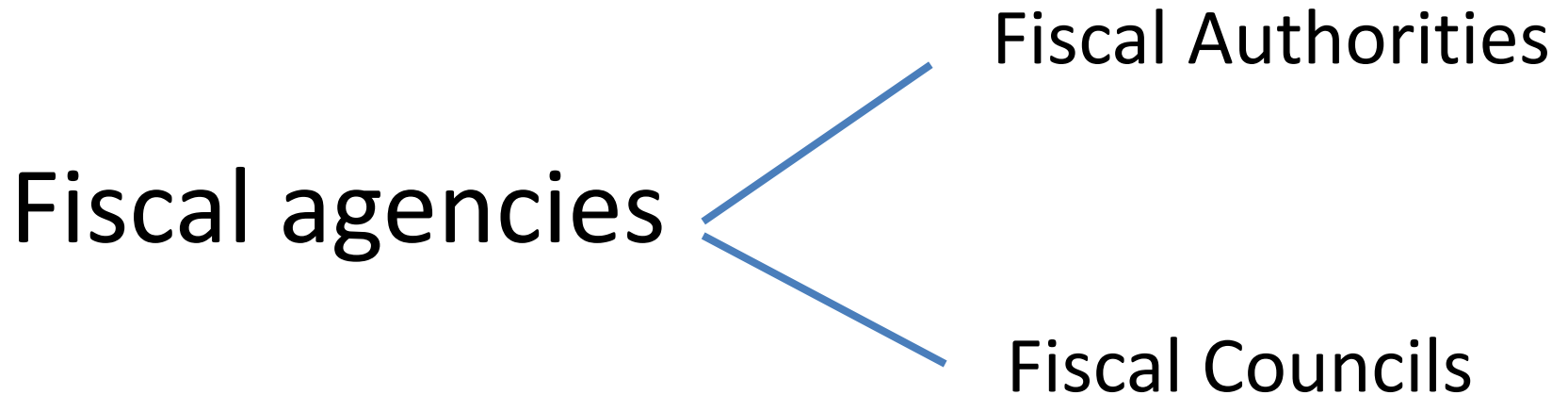
- Conflicts of interest
 - Common pool problem
 - Short political time horizons
 - “Strategic” deficits
 - Asymmetric information
- Time inconsistency and the commitment problem
 - Default as an option
 - Expectations of default → risk premium (and possible complete market exclusion)
 - Danger of falling into a “bad equilibrium”

Fiscal institutions to improve fiscal policy

- Fiscal processes
 - Strong finance departments
 - Medium-term frameworks
 - Fiscal charters
- Fiscal rules
- Fiscal agencies



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Basic rationales for fiscal councils

- Analysis
 - Better identification of appropriate fiscal policy
- Reduce political bias
 - Raise the political costs of running inappropriate fiscal policy

Varieties of fiscal councils

- Examples:
 - United Kingdom (Office of Budgetary Responsibility)
 - Responsible for macro and budgetary projections
 - Consistency of policy with government's own fiscal rules
 - Not mandated to provide an assessment of the appropriateness of the fiscal stance
 - Sweden (Swedish Fiscal Policy Council)
 - Normative mandate



IFAC's mandate

- To provide an assessment of the **soundness of the economic and budgetary projections and forecasts** set out by the Government in the annual Budget and the Stability Programme Update,
- To provide an assessment of the **appropriateness of the fiscal stance** set out by the Government in the Budget and Stability Programme Update, including, the Government's stated medium-term budgetary objective, with particular regard to whether they are conducive to prudent economic and budgetary management, including by reference to the provisions of the European Union Stability and Growth Pact,
- To provide an assessment of whether the budgetary plans set out in the Budget and Stability Programme Update are **consistent with the fiscal rules** which it is proposed to publish as part of a Fiscal Responsibility Bill by the end of the year, and
- To perform such other functions, including an assessment of the implications of budgetary plans for economic growth, investment and employment, as may be assigned by the Minister for Finance



Who we are

- Council
 - Sebastian Barnes (OECD)
 - Alan Barrett (Trinity/ESRI)
 - Donal Donovan (UL/formerly IMF)
 - John McHale (NUIG)
 - Roisin O’Sullivan (Smith College, MA)
- IFAC Secretariat
 - Diarmaid Smyth (Head of Secretariat and Chief Economist)
 - Eimear Leahy (Economist)
 - Rachel Joyce (Administrator)



Delivering on the mandate

- Key capacities
 - Technical competencies
 - Perception of independence
 - Balance between independence and accountability
 - Public visibility
- Permanent design of the council will be put in law as part of the Fiscal Responsibility Bill

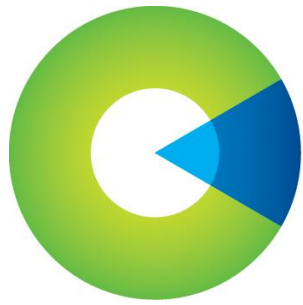


Key outputs

- Required to report three times per year
 - Bi-annual Fiscal Assessment Reports
 - Annual report
 - Shorter supplementary commentaries as required
- Input into the Fiscal Responsibility Bill
 - Department of Finance discussion document outlines Government's draft plans

Value of the council

- Main value is for the long-haul
 - Surveillance to ensure that the vulnerabilities that preceded the crisis are never again allowed to build again
- Input into the development of medium-term fiscal strategy that appropriately balances risks



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Fiscal Assessment Report

October 2011



Fiscal Stance: SPU Targets and Projections

	2011	2012	2013	2014	2015
Gross Debt/GDP (%)	111.0	116.0	118.0	116.0	111.0
General Government Deficit/GDP (%)	10.0	8.6	7.2	4.6	2.8
Primary Deficit/GDP (%)	6.2	3.9	1.1	-1.7	-3.4
Nominal GDP Growth (%)	1.4	3.1	4.0	4.3	4.6
Average Interest Rate (%)	4.0	4.4	5.5	5.6	5.6
Assumed Discretionary Adjustment (Billions)	-6.0	-3.6	-3.1	-3.1	-2.0

Assessment of Budgetary Projections

- Broadly appropriate at time of SPU
- Exchequer returns close to profile
- Significant post-SPU developments
 - Reduction in interest rate on official loans
 - Lower than anticipated cost of bank recapitalisation
 - Nominal GDP - upward revision to 2010; downward revisions for 2011 & 2012



Allowing for Post-SPU Developments

	2011	2012	2013	2014	2015
Gross Debt/GDP (%)	109.1	115.4	117.7	116.9	112.9
General Government Deficit/GDP (%)	9.7	8.8	7.2	4.7	2.8
Primary Deficit/GDP (%)	6.2	4.4	1.6	-1.2	-2.9
Nominal GDP Growth (%)	-0.2	2.1	4.0	4.3	4.6
Average Interest Rate (%)	3.7	4.1	5.0	5.2	5.1
Assumed Discretionary Adjustment (Billions)	-6.0	-3.6	-3.1	-3.1	-2.0



Additional Adjustments Required

	2012	2013	2014	2015
<u>General Government Deficit Target (GGD) (% of GDP)</u>				
Original GGD Targets in SPU	8.6	7.2	4.6	2.8
<u>Estimated Discretionary Adjustments (Billions of Euro)</u>				
Planned Adjustment in SPU	-3.6	-3.1	-3.1	-2.0
Additional Adjustment Required for Original Targets	-0.4	0.4	-0.1	0.0
<i>Total Adjustment Required</i>	<i>-4.0</i>	<i>-2.7</i>	<i>-3.2</i>	<i>-2.0</i>

Assessment of Fiscal Stance

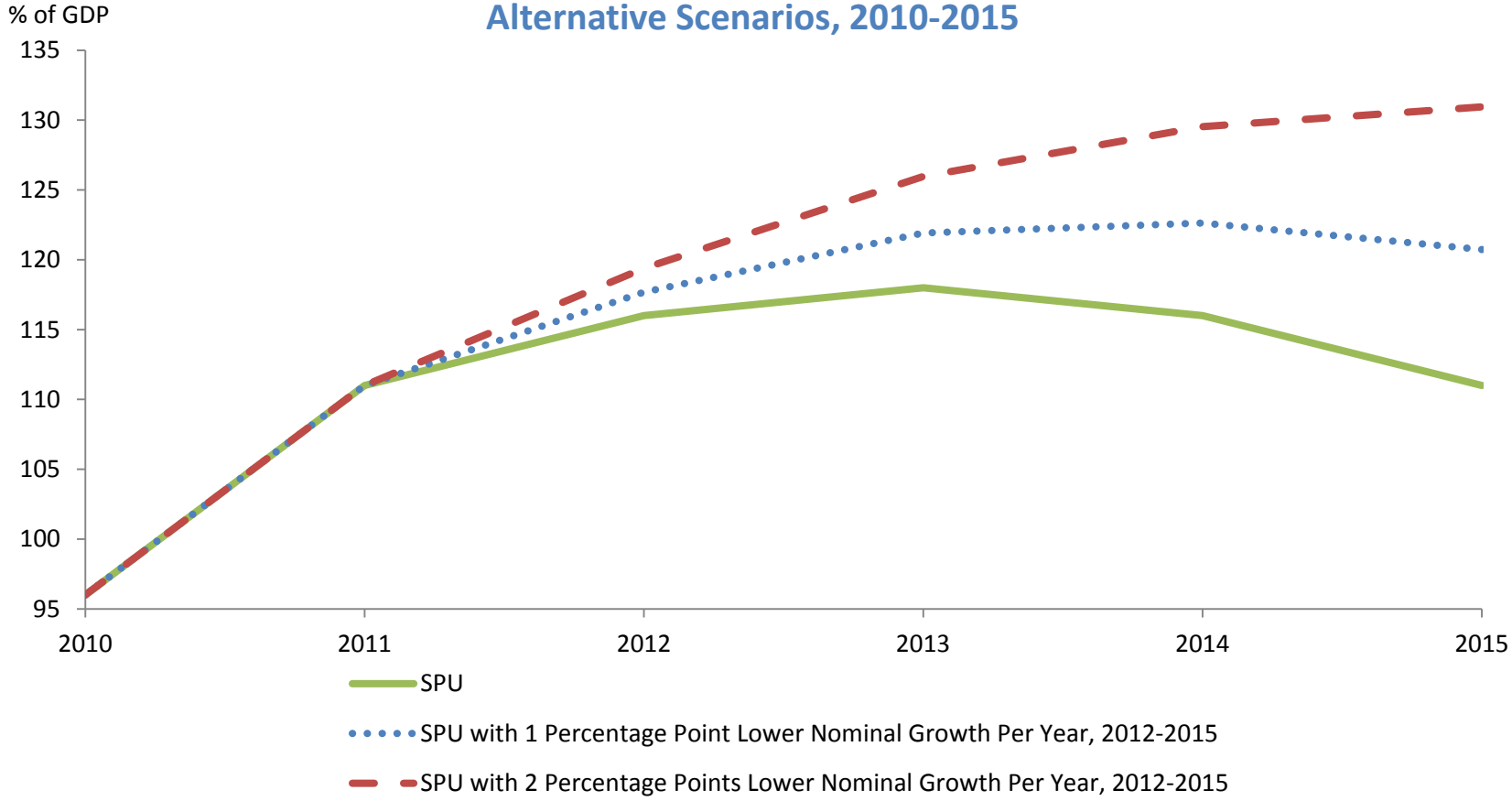
- A difficult balancing act . . .
 - Rebuilding public finances
 - Funding vulnerabilities
 - Effects on domestic demand

- Is there a case for more ambitious targets?



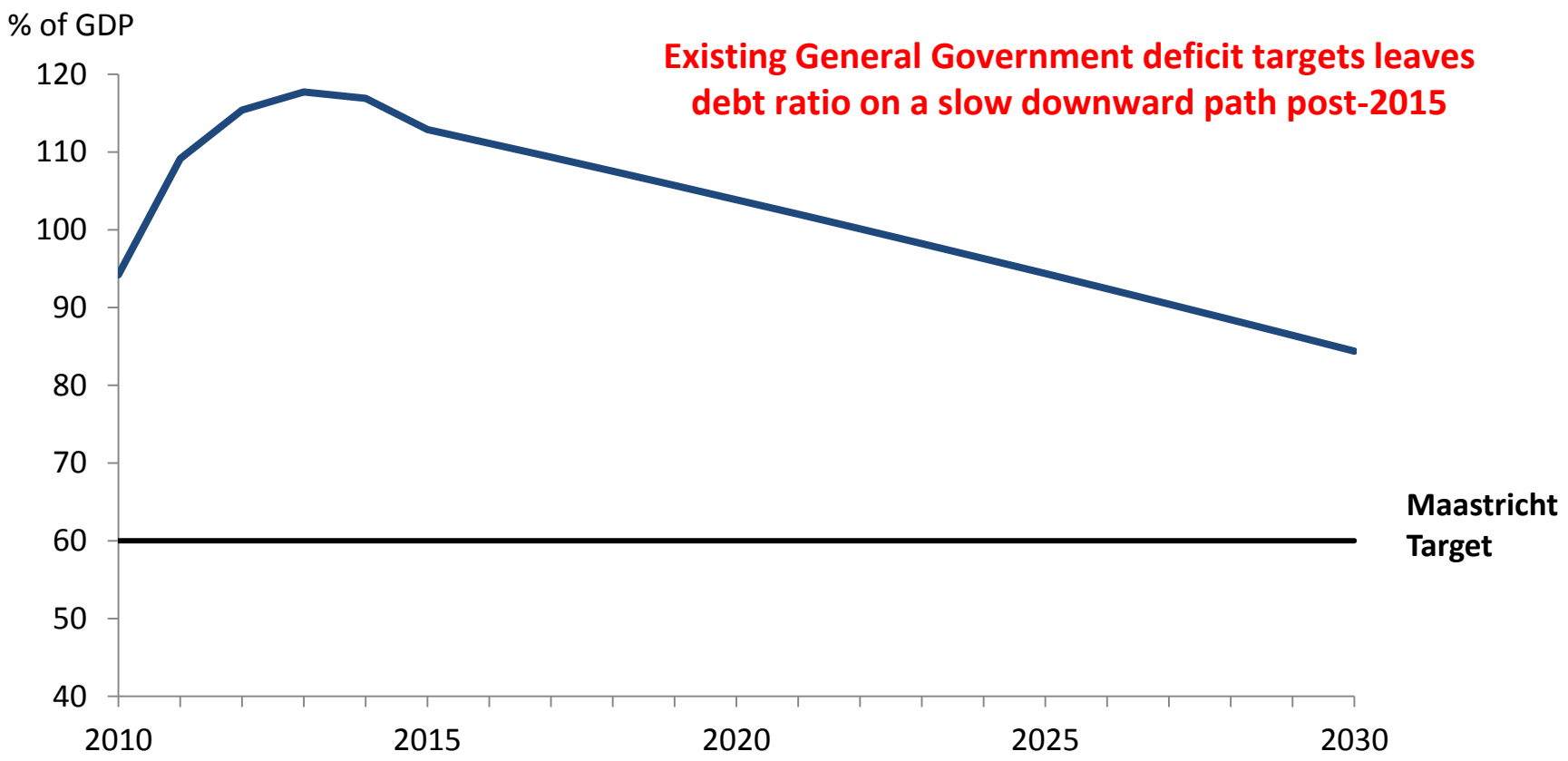
Fragility of Debt Sustainability

**Medium-Term Evolution of Debt/GDP Ratio
Alternative Scenarios, 2010-2015**





Slow Rate of Improvement in Debt/GDP Ratio



Assumptions:
1. 1 percentage gap between nominal interest rate and nominal growth rate, 2016-2030
2. Primary surplus as a share of GDP is held constant at 2015 level, 2016-2030

Funding Vulnerabilities

- Uncertain external environment
 - Market funding vulnerability
 - Official funding vulnerability
- European crisis-resolution policies → Distinction between illiquid and insolvent countries
- Importance of being on the “right list”

Effects on Domestic Demand

- Uncertainty about size of multipliers
- Review of literature suggests deficit multiplier positive but relatively small under current Irish conditions
- Unlikely that fiscal adjustment is “self defeating”
 - Deficit is falling despite weak domestic demand and output

Basic Assessments

- Current General Government deficit (GGD) targets within the range of appropriate fiscal policy stances
- Council sees no case for relaxing targets
- On balance, the Council sees a strong case for more ambitious targets – notably a GGD target of 1% of GDP by 2015

Arguments for more ambitious targets

- Debt ratio on a strong downward path post-2015
- Insurance against shocks
- Timely signal of political capacity

Amended SPU with Revised GGD Targets

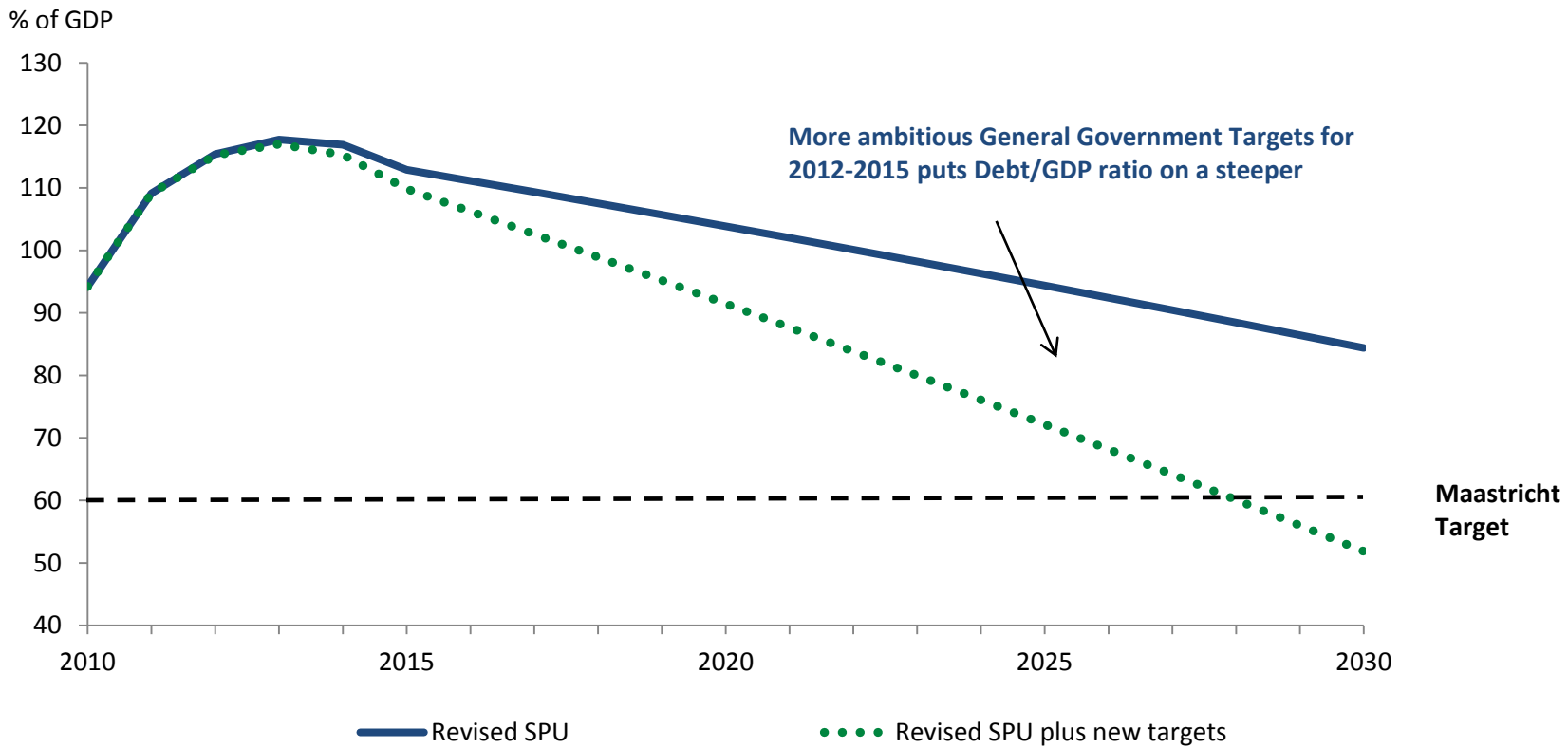
	2011	2012	2013	2014	2015
Gross Debt/GDP (%)	109.1	115.2	117.0	115.3	109.8
General Government Deficit/GDP (%)	9.7	8.4	6.4	3.6	1.0
Primary Deficit/GDP (%)	6.2	4.0	0.9	-2.2	-4.7
Nominal GDP Growth (%)	-0.2	1.9	3.8	4.1	4.2
Average Interest Rate (%)	3.7	4.1	5.0	5.2	5.1
Assumed Discretionary Adjustment (Billions)	-6.0	-4.4	-3.9	-3.8	-3.7

Alternative GGD Targets and Discretionary Adjustments

	2012	2013	2014	2015
<u>General Government Deficit Target (GGD) (% of GDP)</u>				
Original GGD Targets in SPU	8.6	7.2	4.6	2.8
Alternative Targets to get to 1% GGD in 2015	8.4	6.4	3.6	1.0
<u>Estimated Discretionary Adjustments (Billions of Euro)</u>				
Planned adjustment in SPU	-3.6	-3.1	-3.1	-2.0
Additional Adjustment Required for Original Targets	-0.4	0.4	-0.1	0.0
Additional Adjustment Required for Alternative Targets	-0.4	-1.2	-0.6	-1.7
Total Additional Adjustment	-0.8	-0.8	-0.7	-1.7
<i>Total Adjustment Required to Reach 1% GGD Target in 2015</i>	-4.4	-3.9	-3.8	-3.7



Impact of Revised Targets on the Path of Debt/GDP Ratio



Assumptions:
1. 1.1 percentage gap between nominal interest rate and nominal growth rate, 2016-2030
2. Primary surplus as a share of GDP is held constant at 2015 level, 2016-2030



Summary of first report

- Macro forecasts and budgetary projections broadly appropriate at time of SPU
- Significant post-SPU developments
 - 2.8% GGD target for 2015 still achievable
 - 8.6% GGD target for 2012 challenging given own estimates
- Case for more ambitious GGD target for 2015 (3% → 1%)
 - Would require an estimated €4 billion of additional adjustments

Next steps for the first Council

- Input into the Fiscal Responsibility Bill
- Ongoing fiscal surveillance
- Ensure we bequeath a strong pillar of Ireland's fiscal policy architecture
 - Technical competencies
 - Reputation for independence
 - Firmly established public watchdog role